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MASALA BONDS

RUPEE DENOMINATED BONDS ISSUED OVERSEAS

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AMONG OTHERS, REAL ESTATE INVESTMENT TRUSTS (REIT's) & INFRASTRUCTURE INVESTMENT TRUSTS (InvITs) NOW ELIGIBLE ISSUERS

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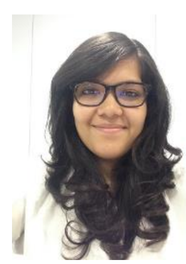

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The Reserve Bank of India ("**RBI**") in September 2015 issued guidelines[1] for issuance of Indian Rupee denominated bonds ("**RDBs**") overseas ("**Guidelines**") which has been recently enhanced. RDBs have ushered a new era for debt-raising by Indian companies, and will integrate financial markets in India further with the rest of the world. Allowing companies to issue RDBs abroad will create new means for both pricing and currency risks, while opening a window for rupee-denominated instruments to trade abroad. This will also aid foreign promoters to invest in Indian entities other than the traditional equity investment channels.

Following the issuance of the Guidelines, the RBI has issued a revised framework for external commercial borrowings ("**ECB**") in the form of Master Directions on ECBs[2], ("**Master Directions**"). In addition to what is provided in the Guidelines, all the conditions usually applicable to ECBs will be applicable to RDBs.

The key stipulations under the Guidelines and Master Directions applicable to RDBs are as follows:

1) **Eligible issuers/borrowers**:
   (a) Any corporate or body corporate; and
   (b) Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) under the regulatory jurisdiction of the Securities and Exchange Board of India (SEBI) are also eligible.

   Individuals, trusts (other than REITs and InvITs), co-operative societies and non-profit making organizations are not eligible issuers of RDBs.

2) **Eligible investors:** Any investor from a country:
   (a) that is a member of the Financial Action Task Force (FATF) or FATF – Style Regional Body; **and**
   (b) whose securities market regulator is a signatory to the International Organization of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to bilateral Memorandum of Understanding with the Securities and Exchange Board of India (SEBI) for information sharing arrangements; **and**
   (c) is not identified in the public statement of the FATF as a jurisdiction having anti-money laundering or combating financing of terrorism deficiencies to which counter measures apply or a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies.

[1] RBI Circular on *External Commercial Borrowings (ECB) Policy - Issuance of Rupee denominated bonds overseas* dated 29th September 2015 and subsequently RBI Circular on *Issuance of Rupee denominated bonds overseas* dated 13th April 2016.

[2] RBI Master Directions on *External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorized Dealers and Persons other than Authorized Dealers* dated 1st January 2016 revised from time to time.

3) Nature of RDBs:

(a) Only plain vanilla bonds issued in FATF compliant financial centres;

(b) RDBs to be either privately placed or listed on exchanges as per host country regulations.

4) Maturity: Minimum maturity period of 3 years. This is in alignment with the maturity prescription for foreign investment in corporate bonds through the FPI route.

5) Options: Permitted. However, neither call, nor put options shall be exercisable prior to completion of the minimum maturity period.

6) Amount:

(a) Issuance of RDBs are required to be within the aggregate limit of foreign investment permitted in corporate debt i.e. INR 2443.23 billion.

(b) Maximum of INR 50 billion per annum may be raised under the automatic route (i.e. without prior permission of the RBI).

(c) Cases beyond this limit will require prior approval of RBI.

7) All-in-cost:

(a) No cap for all-in-cost has been specified. All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees.

(b) All-in-cost to be commensurate with prevailing market conditions.

8) Conversion Rate: At the market rate on the date of settlement for any purpose of the transactions undertaken for issue and servicing of the bonds.

9) Permitted end-use:

(a) The proceeds from the issuance of the RDB can be used for any purpose including development of integrated townships and affordable housing projects. This can include for onward lending where the borrower is not applying the proceeds for on-lending for end uses which are prohibited (as specified in (b) below).

(b) The following end-uses are not permitted:

(i) Real estate activities (other than as permitted);

(ii) Investing in capital market and using the proceeds for equity investment domestically;

(iii) Activities prohibited as per the foreign direct investment (FDI) guidelines[3];

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[3] FDI is prohibited under the Government Route as well as the Automatic Route in the following sectors:

(i) Atomic Energy;
(ii) Lottery business;
(iii) Gambling and Betting;
(iv) Business of Chit Fund;
(v) Nidhi Company;
(vi) Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations);
(vii) Trading in Transferable Development Rights (TDRs); and
(viii) Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

(iv) On-lending to other entities for any of the above objectives; and

(v) Purchase of land.

10) Restriction on Indian Banks:

Banks incorporated in India are not permitted to access the RDBs except in the following manner:

(a) Acting as arranger and/or underwriter for the RDB issuance.

(b) In case of underwriting, holding of Indian banks cannot be more than 5 per cent of the issue size after 6 months of issue of the RDB. Such holding is subject to applicable prudential norms.

11) Hedging:

(a) The overseas investors may hedge their exposure in Rupee through permitted derivative products with Authorized Dealer Category - I banks in India.

(b) The investors can also access the domestic market through branches/subsidiaries of Indian banks abroad or branches of foreign banks with an Indian presence on a back to back basis.

12) Tax implication: Indian income tax authorities will levy 5% withholding tax on RDBs. Capital gains, arising in case of appreciation of rupee between the date of issue of the masala bonds and the date of redemption against the foreign currency in which the investment is made will be exempt from capital gains tax.

13) Parking of bond proceeds: Borrowers are permitted to either keep RDB proceeds abroad or to remit these funds to India, pending utilization for permitted end-uses.

14) Guarantee for RDBs:

(a) Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by Indian banks, Indian financial institutions and NBFCs relating to Masala Bonds is not permitted; and

(b) Exceptions are provided for Small and medium size enterprises (SMEs) and textile companies.

15) Security for RDBs:

(a) The choice of security to be provided to the lender / supplier is left to the borrower.

(b) Charge may be created over immovable assets and financial securities, such as shares, in favour of the overseas investor subject to certain conditions.

16) Documentation

(a) Borrowers issuing RDBs should incorporate clause in the agreement / offer document so as to enable them to obtain the list of primary bond holders and provide the same to the regulatory authorities in India as and when required.

(b) The agreement / offer document should also state that the bonds can only be sold / transferred / offered as security overseas subject to compliance with aforesaid

IOSCO / FATF jurisdictional requirements.

17) **Conversion into equity:**
Conversion of RDBs into equity is permitted subject to certain key conditions:
(a) The activity of the Indian company is covered under the Automatic Route for Foreign Direct Investment or Government (Foreign Investment Promotion Board) approval for foreign equity participation has been obtained by the company, wherever applicable.
(b) The foreign equity holding after such conversion of debt into equity is within the sectoral cap, if any.
(c) The applicable pricing guidelines are complied with.

The Framework and the Master Directions provide that in case of conversion of ECB dues into equity (including in the context of RDBs), the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion or any lesser rate can be applied with a mutual agreement with the ECB lender. The fair value of the equity shares to be issued must be worked out with reference to the date of conversion only.

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